No. 251

# In the Supreme Court of the United States

OCTOBER TERM, 1941

IN THE MATTER OF INDEPENDENT AUTOMOBILE FORWARDING CORPORATION, BANKRUPT

STATE OF NEW YORK, PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

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### OPINIONS BELOW

The second opinion of the District Court for the Western District of New York (R. 13–18) is unreported. The first opinion of that court is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 25–30) is reported in 118 F. (2d) 537.

### JURISDICTION

The judgment of the court below was entered April 12, 1941 (R. 31). The petition for a writ of certiorari was filed July 9, 1941. The jurisdic-

tion of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

1. Should the claim of the United States for social security taxes owed by a bankrupt be allowed in the amount computed by the mathematical formula approved by the courts below, or should it be reduced in accordance with a different formula presented by the bankrupt in order to give effect to the 90% credit provided in certain cases by Title IX of the Social Security Act?

2. Is the claim of the United States for social security taxes, computed in accordance with the formula approved by the courts below, a claim for a penalty of the type not provable under Section 57 (j) of the Bankruptcy Act?

## STATUTES INVOLVED

Social Security Act, c. 531, 49 Stat. 621, 639:

> Title IX—Tax on employers of eight or more.
>
> Sec. 902. The taxpayer may credit against the tax imposed by section 1101 of this chapter the amount of contributions, with respect to employment during the taxable year, paid by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law. The total credit allowed to a taxpayer under this section for all contributions paid into unemployment

funds with respect to employment during such taxable year shall not exceed 90 per centum of the tax against which it is credited, and credit shall be allowed only for contributions made under the laws of States certified for the taxable year as provided in section 1103 of this chapter. (U. S. C. Supp. V, Title 42, Sec. 1102.)

As amended by the Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360, 1399, effective August 10, 1939, Section 902 of the Social Security Act provides:

(a) Against the tax imposed by section 901 of the Social Security Act [section 1101 of Title 42] for the calendar year 1936, 1937, or 1938, any taxpayer shall be allowed credit for the amount of contributions, with respect to employment during such year, paid by him into an unemployment fund under a State law—

* * * * *

(3) Without regard to the date of payment, if the assets of the taxpayers are, at any time during the fifty-nine-day period following such date of enactment, in the custody or control of a receiver, trustee, or other fiduciary appointed by, or under the control of, a court of competent jurisdiction.

* * * * *

(i) No part of the tax imposed by the Federal Unemployment Tax Act or by title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit

against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57j of the Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended. (U. S. C. Supp. V, Title 42, Sec. 1102 note.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544:

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * *

(j) Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law. (U. S. C., Title 11, Sec. 93 (j).)

## STATEMENT

The Independent Automobile Forwarding Corporation was adjudicated a bankrupt in the District Court for the Western District of New York on April 26, 1938 (R. 1). After liquidation of the property, the trustee had assets of $3,053.20, which were insufficient to pay in full the claims filed and allowed priority under Section 64 of the Bankruptcy Act (R. 5, 7–8, 13). The trustee accordingly filed a petition requesting directions from

the court as to the order of priority of the various claims (R. 6–9). Priority claims of the United States and of the State of New York are so large as to absorb the entire amount remaining in the hands of the trustee, irrespective of the outcome of this litigation (R. 13); accordingly, they are the only parties in interest in the proceeding.

Among the claims of the United States is one for taxes under Title VIII of the Social Security Act. The question whether this claim is entitled to priority is now pending before this Court on petition for a writ of certiorari, No. 238, filed by the Government. The decision in that proceeding will affect the amount of taxes collectible by each claimant, but the present petition is not otherwise dependent on the outcome of No. 238.

The instant petition is concerned with the manner in which the amount of social security taxes payable to the United States under Title IX of the Social Security Act should be computed. The method of computation presented by the United States involves the use of a mathematical formula which shows the percentage of the available funds to be applied to each claim.[1] The petitioner advo-

[1] By means of the formula, the total funds available for distribution ($T$) are equal to a certain percentage ($X$) of the total amount of taxes claimed by the State of New York ($A$) and by the United States ($B$), less the amount of the credit against the Title IX taxes ($XA$). The latter figure is equal to the amount of unemployment insurance taxes actually paid to the State, which is equivalent to the state's

cates the use of a different formula, which is described in detail in the petition and the appendix thereto. The petitioner maintains that the Government's method results in a partial disallowance of the 90% credit permitted by Section 902 of the Social Security Act, and that such denial amounts to the imposition of a penalty which would not be provable in bankruptcy.

The District Court approved the method of computation presented by the Government (R. 14–16) and its decision in this respect was affirmed by the Circuit Court of Appeals (R. 28–30).

## ARGUMENT

1. The petitioner alleges that the Government's formula for computing the proportion of each claim to be paid out of the available funds deprives the taxpayer of the full 90% credit permitted by Section 902 of the Social Security Act. However, the Act does not authorize a credit of 90% of the

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claim ($A$) reduced by the appropriate percentage figure ($X$). The formula then takes the following form, when solved for X:

$$X=\frac{(A+B)-\sqrt{(A+B)^2-4(AT)}}{2A}$$

If the figures representing the appropriate tax claims are substituted for the above symbols, $X$ will be found to equal 25.96%. If this percentage is applied to each claim, including the claim of the United States under Title IX reduced by the proportion of the state's claim for unemployment insurance allowed, the amounts approved by the District Court are obtained (R. 14).

taxes *assessable* under Title IX, as petitioner assumes. To the contrary, the credit is specifically limited to "the amount of contributions * * * *paid* by him (before the date of filing his return for the taxable year) into an unemployment fund under a State law." [Italics supplied.] Section 902 of the Social Security Act, *supra*. Consequently, the credit may in no event amount to more than the sum actually paid to the state.

In the instant case, the amount to be paid to the state under the formula advocated by the Government is $858.42 (R. 14). In computing the payments to be made on the other priority claims, this $858.42 was deducted from the amount of the claim of the United States for taxes under Title IX of the Social Security Act. The latter claim, which amounted to $3,400.49 (R. 13), was thus reduced to $2,542.07. This sum was in turn reduced by application of the percentage found by the solution of the quadratic equation, namely, 25.967%. The resulting computation reveals that the sum of $660.10 should be paid on the claim of the United States under Title IX. The use of this formula constitutes an allowance of a credit, mathematically computed in an equitable manner, to the fullest extent permitted by the Act.

It is unnecessary to analyze in detail the alternative formula offered by petitioner, since the method used by the District Court and approved by the court below fully conforms to the statutory require-

ments. It may be noted, however, that petitioner's entire formula (Pet. 25) is based upon the assumption that the amount of credit to be allowed is 90% of the proportion of the bankrupt's assets available for payment of social security taxes to the United States without regard to the credit (if that amount does not exceed the amount paid to the state), rather than 90% of the tax imposed by the statute. This assumption is directly contrary to the statute. Section 902 of the Act specifically provides that the credit is to be taken against "the tax imposed" by Title IX. Under this statutory direction, it is plain that the credit is to be taken against the full amount of the claim of the United States for Title IX taxes. This being so, the amount of the credit must, of course, be determined by some formula such as that advanced by the Government before a computation may be made as to the amounts available for distribution to the various parties.[2]

2. Petitioner contends that 90% of the federal tax, computed without regard to the credit, consti-

[2] Stated otherwise, the amount available for distribution depends upon the amount of the credit, and the amount of the credit, in turn, depends upon the amount available for distribution, since the credit cannot exceed the amount actually paid to the state. As the court below pointed out (R. 28), the amount of the credit and the amounts available for distribution are thus "variables dependent upon each other" which cannot be computed by simple arithmetic, as petitioner seeks to do.

tutes a penalty for failure to pay an equal sum to the state, and accordingly that any claim for an amount greater than the remaining 10% of the tax is not provable under Section 57(j) of the Bankruptcy Act. The contention is untenable. Congress recognized that an employer who pays social security taxes to a state should be allowed to deduct the amount of that payment from his federal tax, since the Government's need for revenue for the purposes of the Act is *pro tanto* reduced. *Steward Machine Co.* v. *Davis,* 301 U. S. 548, 589. However, in order to prevent an undue competitive advantage to those employers who operate in states having no social security laws, or who fail to pay the taxes in full, the 90% credit is withheld in cases where no payment to the state is made. This does not result in the payment of more taxes, but merely assures an equal burden on all employers. The credit provisions involve no more of a penalty than the section of the revenue act which permits a deduction for gifts to charity. The higher taxes paid by those who fail to give represent simply the normal burden of taxation, not penalties.

In the instant case, the taxpayer is not required to pay increased taxes by reason of his payment to the state of a sum which is less than 90% of the United States' claim. To the contrary, the aggregate amount of all taxes paid will be less than the state's claim for unemployment insurance taxes

plus 10% of the claim of the United States for social security taxes under Title IX. There is, therefore, no substance to the allegation that the taxpayer is penalized.

In the two decisions of this Court cited by the petitioner as probably conflicting with the decision below (*Carter* v. *Carter Coal Co.*, 298 U. S. 238; *United States* v. *Constantine*, 296 U. S. 287), an extra tax burden was imposed upon taxpayers failing to comply with certain regulatory provisions contained in the particular statutes involved. Consequently, unlike the instant situation, the taxpayers in those cases would ultimately pay more if they violated than if they complied with the condition stated in the law.

The petitioner has cited several district court decisions as conflicting with the decision below (Br. 19). In those cases the denial of the 90% credit arose out of the failure of the taxpayer to pay the state taxes within the time required by law. However, the state taxes were paid after such date. Consequently, if the credit on the federal tax had not been allowed, those taxpayers would have paid more, in the aggregate, than if they had paid the state taxes within the time allowed. In such cases the denial of the credit partakes more of the nature of a penalty than it does in the case at bar, although the United States does not concede that even in such cases it should be

deemed a penalty. The distinction between the two types of situations was recognized by Congress in amending Section 902 of the Social Security Act on August 10, 1939. Section 902 (a), as amended, expressly provides that the credit should be allowed in full if the state contributions are paid, even though late, if the assets of the taxpayer were in the hands of a court during a designated period following enactment of the amendment.

Even if the tax involves a penalty, it is not the type of penalty referred to in Section 57 (j) of the Bankruptcy Act. In Section 902 (i) of the Social Security Act, as enacted on August 10, 1939, Congress expressly stated that the words "penalty or forfeiture" as used in the Bankruptcy Act do not include any part of the tax imposed by the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax. The legislative history of this enactment shows plainly that it was not intended to effect a substantive change in the prior law, but was designed merely to set at rest the question presented in numerous pending cases. S. Rep. No. 734, 76th Cong., 1st Sess., p. 91.

## CONCLUSION

The decision below is correct, and there is no conflict of authority. No sufficient reason has been shown for review, and the petition should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
*Acting Solicitor General.*
SAMUEL O. CLARK, JR.,
*Assistant Attorney General.*
SEWALL KEY,
RICHARD H. DEMUTH,
MICHAEL H. CARDOZO IV,
*Special Assistants to the Attorney General.*

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